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September 6, 1996

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SEP 6 - 1996

FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF SECRETARY

Ex Parte

Mr. William F. Caton
Acting Secretary
1919 M Street, NW, Room 222
Washington, D.C. 20554

RE: CC Docket No. 96-112, Allocation of Costs Associated with LEC Provision of Video Programming Services

Dear Mr. Caton:

Today, R. Blau, M. Tanner and the undersigned, representing BellSouth, met with J. Nakahata, Legal Advisor to Chairman Hundt to discuss BellSouth's position regarding the above-referenced proceeding. The discussion was consistent with BellSouth's position already filed in this proceeding. The attached documents were provided to Mr. Nakahata during the discussion. In addition, a copy of written ex parte comments filed by Professor Alfred Kahn on July 19, 1996 in this proceeding was also provided to Mr. Nakahata.

Pursuant to Section 1.1206(a)(2) of the Commission's rules, two (2) copies of this notice and the attachment are being filed with the Secretary of the FCC.

Sincerely,

Maurice P. Talbot, Jr.

Maurice P. Talbot, Jr.
Executive Director - Federal Regulatory

Attachment

cc: J. Nakahata

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Cable Rates Are Up an Average 10.4% This Year

By ALBERT R. KARR
Staff Reporter of THE WALL STREET JOURNAL

WASHINGTON–Cable-television rates are soaring again – up an average of 10.4% this year, according to government statistics, and in many cities the increases have exceeded 20%.

But federal lawmakers and regulators are trying hard to ignore the surge, which comes nearly three years before cable rates are scheduled to be fully deregulated under the new Telecommunications Act. That is a major change in attitude since 1992 when Congress overwhelmingly passed a bill to rein in skyrocketing cable rates, and the Federal Communications Commission followed up with rules it claimed could cut rates 17%, declaring that "hyperinflation of cable rates is dead and gone."

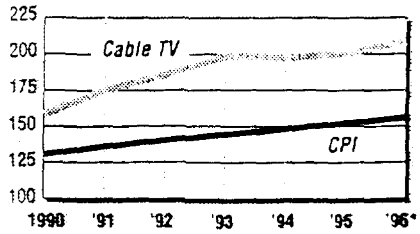
The new Telecom Act, however, swept away much of the 1992 cable law, replacing regulation with a philosophy that competition from satellite services, telephone companies and other new video rivals would force cable companies to keep a lid on rates, if not lower them. Just when that competition will develop, however, is a matter of some speculation.

In the absence of tough competitors, Englewood, Colo.-based **Tele-Communications** Inc., the nation's largest cable company, has boosted rates about 13.5% this year. Time Warner Cable, a unit of New York-based **Time Warner** Inc., raised rates about 10%. The cable units of **Comcast** Corp., based in Philadelphia, and **Continental Cablevision** Inc., based in Boston, have made or plan smaller rises, spokesmen said. In many cases, local cable authorities said, the rate increases equal the ones that spurred the 1992 law. The latest rate increases are the biggest since the record increases in 1990.

Watch That!

Faster than CPI

A comparison of the average annual consumer price index and cable-TV price index trends since 1990. December 1983=100



*First seven months

Sources: Bureau of Labor Statistics, U.S. Labor Dept.

Rising Revenues—and Rates

Estimated average monthly revenues per cable TV subscriber:

June 1996	$36.02
June 1995	33.88

Estimated average monthly rate for combined basic and expanded basic program packages:

June 1996	$24.57
June 1995	23.07

Source: Paul Kagan Associates

Complaints From Subscribers

July data from the Labor Department's Bureau of Labor Statistics show that cable-TV rates have climbed at an annual pace of 10.4%, compared with 3.5% for consumer prices overall. Last year, cable costs rose 4.1% after dropping 2.6% in 1994, the year the FCC crackdown on rates was fully in effect. Overall consumer prices rose 2.5% in 1995 and 2.7% in 1994.

Consumers aren't happy with the latest trend. Since the Telecom Act was enacted in February, the cable authority in Hillsborough County, Florida, has received more than 100 complaints from subscribers to the Time Warner Cable system, said Frank Turano, the county's cable communications director. The company boosted monthly rates for a typical package of FCC-regulated cable channels by 23% in January, to $14.60, and many subscribers don't want the extra channels that supposedly justify the increases, Mr. Turano told the FCC in a complaint letter filed in April.

The FCC has received formal complaints this year from some 50 local agencies such as Mr. Turano's. Jeffry Allred, assistant city manager for LaVerne, Calif., said in one complaint that the May 1 rate increases imposed by **Century Communications** Corp., based in New Canaan, Conn., are "excessive, particularly considering the fact that no new channels were added." In Santa Monica, Calif., retirees Clyde and Katherine Walker and Wally Grayson wrote to their local cable authority complaining that Century's 30% rate increase to $28.16 a month is "outrageous" and "arbitrary."

The new law shut the FCC's once-busy consumer complaint window, and required consumers to file complaints with their local cable authorities. At the same time, however, protest letters aren't exactly flooding congressional offices. "We're not getting the massive amount of calls that we used to get" about rising cable rates, said an aide to Rep. Edward Markey (D., Mass.), a leader of the effort to regulate cable rates in 1992. Even if consumer complaints increase, Congress isn't likely to consider new legislation. While lawmakers could ask the FCC to "recalibrate" its rules, "it would be a painful process that would end just as competition [for cable TV] is arriving," the Markey aide said.

Satellite Services

The cable industry and its political supporters say cable companies must be mindful of competitive threats. Direct broadcast satellite companies, such as DirecTV Inc. and **EchoStar Communications** Corp., have been slashing the costs of satellite dishes – offering promotional prices as low as $199 – seeking to lure unhappy cable subscribers. Bob Thomson, TCI's vice president for government affairs, said cable service and rates are still better than satellite services. Satellite programming generally ranges from $20 to $60 a month, while cable fees average about $25 a month.

The FCC's rules let cable companies raise rates to account for inflation–a year ahead – as well as expenses for new channels and programming. Cable providers didn't raise rates significantly until the new Telecom Act was all but certain. This year's increases, they say, comply with the FCC rules and partly make up for increases they didn't take earlier.

Meantime, the FCC appears to have washed its hands of the situation. "We're just following the new law," said FCC Chairman Reed Hundt. "I haven't had anyone tell me there have been any violations." Consumers should take their problems up with Congress, he said.

THE WALL STREET JOURNAL TUESDAY, AUGUST 6, 1996

Ask Not the Bells for Tolls

By ALFRED E. KAHN

The Telecommunications Reform Act of 1996, while not perfect, is a major achievement. Its central goal is clear and just right: "to provide for a pro-competitive deregulatory national policy framework designed to accelerate rapidly private-sector deployment of advanced telecommunications and information technologies . . . by opening all telecommunications markets to competition." Local and long-distance phone companies, cable TV firms and new ventures will be able to provide the full range of telecommunications services, and consumers will reap the benefits of competition.

The Federal Communications Commission is now writing regulations to carry out the new law's provisions. But the FCC seeks to do one thing that would conflict fundamentally with the law's goals. The commission proposes to formulate rules for allocating the economic costs and benefits from the new facilities—largely fiber optic networks—that telephone companies are building to provide both unregulated services like video programming and regulated phone services. In particular, the commission stated in its notice preceding the new regulations: "We believe that telephone ratepayers are entitled to at least some of the benefit of the economy of scope between telephony and competitive services."

The rationale is understandable. Regulatory commissions are responsible for protecting captive purchasers of regulated services by setting rates at cost plus a reasonable return. They have traditionally thought it necessary to decide what portion of the costs of facilities constructed to provide both regulated and unregulated services could be attributed to the former and recovered in their prices. Such cost-allocation decisions are inevitably political, once they go beyond those costs that are unambiguously attributable to the separate services—such as the cost of video programming on the one side and of completing calls on the other.

The principal example of cost allocation has been the subsidization of residential phone service, particularly in rural areas, at the expense of higher charges to long-distance callers and business customers in central cities. (Not surprisingly, therefore, as competition has come to the industry, it has concentrated on the latter two, grossly overpriced services. Every major downtown area in the country, for example, now has at least one "competitive access provider" providing local service and catering mainly to big business customers.)

The FCC is under pressure to play the same kind of game in the present case. Cable companies, eager to forestall telephone companies' entry into video, argue that all the costs of these joint facilities ought to be borne by the competitive services, but that the benefits should be used in part to reduce phone rates. "Consumer advocates"—who tend to think the only interest consumers have is in holding down the price of regulated services—echo the argument. And even the phone companies themselves (which I have represented in other cases, but not in this one) are arguing only for a "reasonable" allocation of the costs and benefits. History suggests that the FCC will feel obliged to strike a "fair balance" among these demands.

The commission might allocate a share of the revenues from the unregulated services as a "royalty" payment to telephone customers for the use of the company name, subscriber lists and contacts and the product of past, ratepayer-financed research and development. It might require companies to allocate some of the savings from using fiber optic networks—far cheaper to maintain than copper ones—to reduce the prices of the regulated services. Or it might reallocate to the unregulated activities some of the costs of past investments in the common facilities, which could in turn trigger decreases in the prices of the regulated services.

Any of these approaches would simply discourage investment in new communication facilities and thereby hinder competition. The greater the share of the benefits that go to subsidize regulated services, the higher the net revenues from the new services would have to be to justify the investment. Investors in these new services ought to bear the entire additional costs themselves—but they must also be assured that they will reap the full benefits.

Thus, the prices of the regulated telephone services should be neither raised to recover any of those costs nor reduced to share in the benefits. Consumers of regulated phone service would bear *none* of those additional costs and receive *none* of the direct benefits. But they would be better off because of the availability of the new services and the lower prices that would result from competition.

The FCC should simply get out of the way and leave the decisions to investors and consumers. The commission should call off its cost-allocation rule making, leave the prices of regulated services where they are and let the market work.

Mr. Kahn is a professor emeritus of political economy at Cornell University and a special consultant for National Economic Research Associates. He formerly served as chairman of the New York State Public Service Commission and the federal Civil Aeronautics Board.